



RETIREE HEALTHCARE: LEARNING & ENGAGING IN SOLUTIONS JANUARY/FEBRUARY 2008

BACKGROUND INFORMATION

Before we begin asking questions and soliciting input from you, we want to spend 10 or 15 minutes discussing the context in which these issues are set. We have tried to anticipate some of the questions you may have and we have used a Q & A format. After we are finished with this, we plan to ask you whether there are any other questions you have that we have not anticipated.

Why are we discussing this issue at all?

Although the regulations were issued in 2004 the new accounting requirements became effective this year for agencies having \$100 million or more in annual revenue. This requirement was set by the Government Accounting Standards Board (or GASB). GASB requires employers to show on their annual financial statements the expected future cost (liability) of their retiree health care benefits.

What's important about having to show retiree costs?

Virtually all employers have paid for retiree health benefits on a pay-as-you-go basis which means that this year's costs are recognized and paid this year. But the costs for next year and all future years have not been accounted for in the past, and few employers have pre-funded that cost. This is different from pension costs where the future liability is stated and organizations have set aside funds to ensure that those benefits can be delivered.

What does this cost mean to me as an individual?

We honestly do not know. We are not at a point where we can identify potential solutions. At some later time, when possible solutions are identified, we would need to determine their actuarial costs. Right now, we are just trying to gather ideas about potential ways to address the issues we face.

What happens if money is not set aside for these future costs?

In the case of San Jose, three different actuaries have estimated the long term future cost liability of the City's retiree health promise. Two actuaries were hired by the two Retirement Boards and one actuary was hired by the City. Their estimated GASB liabilities range from \$1.2 to \$1.65 billion. While many organizations have not funded any of their liability, based on the current partial funding the retiree healthcare benefits in the Police and Fire Department Plan is approximately 5% funded; the Federate City Employees' Retirement System is 10% funded. If the City and employees do not set aside enough money to adequately fund future costs, then the estimated underfunding is expressed as a liability on the City's accounting books which may result in negative consequences. GASB 45 goes beyond an accounting issue given that ignoring these new requirements could be detrimental to the City and the services it provides.

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What are the options?

There are three possible actions to take in response to this liability: 1) no action which may result in negative consequences, 2) partial payment of the total obligation or 3) full payment of the total annual obligation (this is called an “Annual Required Contribution” or ARC). In addition to estimating the total liability, all three actuaries have estimated the cost of this ARC.

Retiree health liabilities and pension liabilities are very similar in the sense that they represent the cost of future benefits. This includes current retirees, employees who will eventually retire and any prospective employees. In pension plans, the majority of total assets (between 50%-66%) come not from employer or employee contributions but rather from asset growth because of investment returns. As a result, the more money the City and its employees can provide on a 50/50 basis annually, the more it can rely on investment growth rather than employer and employee contributions.

What, if any, other options might be considered?

The City and other stakeholders certainly want to explore the variety of contribution and investment strategies it could adopt but we could also look at other options. These could include more aggressive risk reduction strategies, benefit design changes, eligibility changes, use of individual investment options and many other ideas (many of which we hope will come from you). **The important thing to understand now is that we are not at a stage where we are determining what we are going to do. Rather, we are at the stage where we are asking for your ideas about how we should approach this issue.** This is the whole point of having the sessions.

Why is the City holding these discussions?

For two primary reasons. First, we want to provide an opportunity for all stakeholders (including employees, retirees and others) in helping us identify all the possible solutions. As noted in the joint CLA-City Manager memo, this is part of a new collaborative effort that Labor and the City have undertaken together. Second, we want to continue to listen to all stakeholders to learn which option or options are most mutually advantageous. We don't pretend to have this figured out and we need to engage in serious discussions about the best way to handle this issue. We think that we have the best chance of coming up with creative and workable options if we conduct these discussions through collaboration and open and honest communication. As a bit of additional background information, California retirement systems are, on average, about 88% funded. This means about 88% of the estimated funds that will be needed to deliver the promised pension benefits are already set aside. However, the funding figure for retiree health obligations is much lower. In fact, because this is a new requirement, many organizations are 0% funded. The City has partially funded this obligation (an estimated 5% for Police and Fire and 10% for Federated City employees). But even in the best cases, there is a significant gap between what is set aside and what needs to be set aside to deliver retiree health care benefits. That's why it is so important to begin developing strategies now to address this issue.

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How many of these sessions are going to be held?

We don't know for sure yet, but we are scheduling meetings for employees, retirees, labor organizations and unrepresented employees.

What is the point of these sessions?

There are two major purposes for these sessions. First, we want to hear any ideas you have for addressing this issue, either in terms of processes we should consider or solutions we should explore. Second, we want to capture your ideas and suggestions and bring them before the City Council. That is what we have been hired to do – to collect and accurately record your ideas. These ideas will be evaluated in subsequent steps.

How can I find out more about this issue and what is going on?

There are a number of ways to get more information. First, the City has developed a website on which we will post a lot of information. The website can be accessed at <http://www.sanjoseca.gov/retireehealthcare>.

Second, as we meet with all stakeholders we will record the ideas and suggestions they provide and we'll post that information on the website as well. This way, you can see not only the ideas that came out of the meeting you attended, but also the ideas that are being captured in the other meetings as well.

Third, we will be continuing to collect information from other employers on what strategies they are considering and implementing. We will post what we find from those sources as well.

Fourth, we will be summarizing all the information we are receiving and a jointly-developed report to the City Council will be prepared. You will be able to see that report as it is being developed.

What will happen after the report is provided to the City Council?

We are not sure exactly what action the City Council may take but we expect they will consider the ideas you have communicated and begin exploring which options are likely to be most effective in addressing the issue of retiree health costs.